Financial Market Weekly

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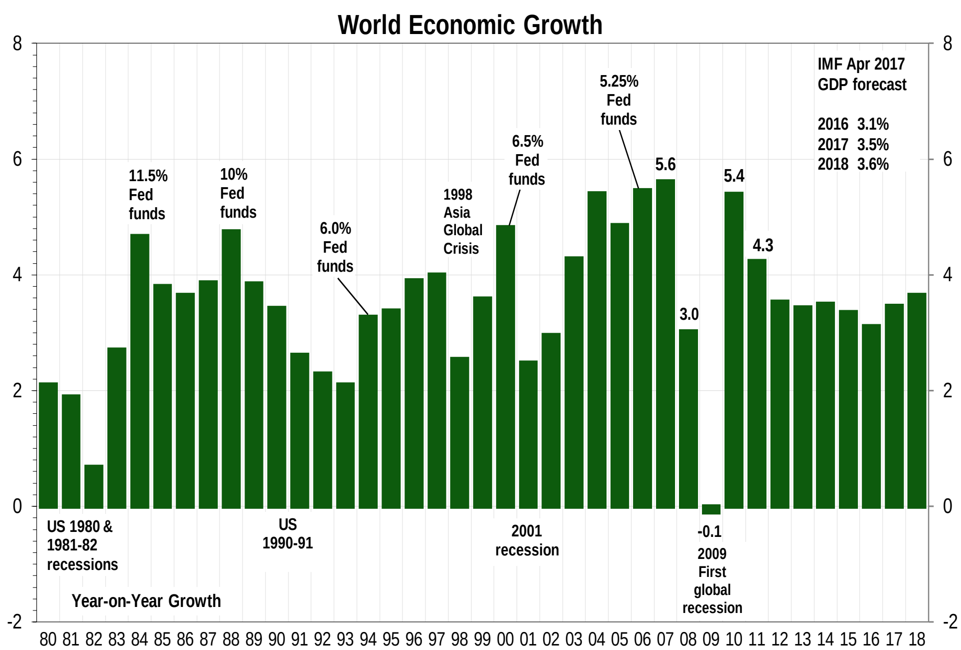
19 MAY 2017

IT'S A CRAZY MIXED UP WORLD EXCEPT WHEN IT COMES TO GROWTH

They keep writing stories about the current state of economic forecasting, that it isn't working. You cannot predict the future. But it is remarkable how steady the trend of world economic growth looks in recent years despite all the risks that were thrown in its path. The world keeps on spinning.

After the two years of faster growth reflecting pent-up demand, catching up after the first global recession in modern economic history, world growth was remarkably steady printing either 3.4 or 3.5 percent for a four year period: 2012, 2013, 2014, and in 2015. Growth slowed if that is the word to 3.1% in 2016, but the IMF outlook with which we agree is for a return in growth to 3.5% in 2017, 3.6% in 2018 and 3.7% in 2019.



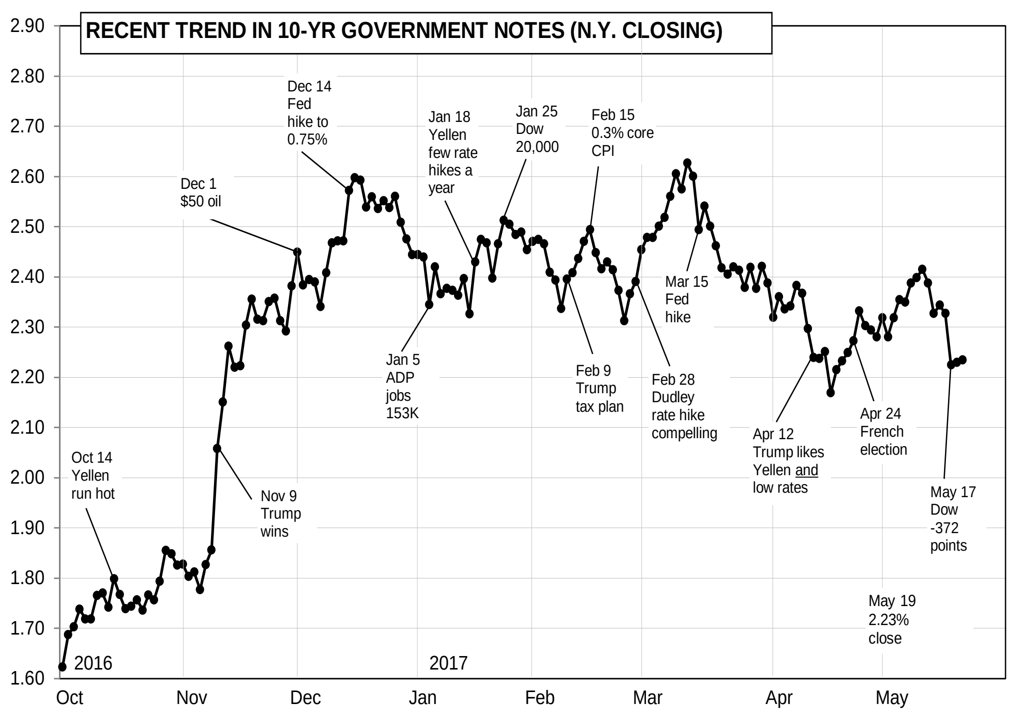
The IMF does these World Economic Outlooks (WEO) twice a year in April and October and then provides smaller, less comprehensive updates in January and July. The WEO titles generally focused on the risks, and outright danger at times, since 2012, yet growth continued at the same, steady 3.4 to 3.5 percent rate over 2012 to 2015. The year 2016 saw weaker growth at 3.1% and this was due primarily to the U.S. where growth dropped from 2.6% in 2015 to 1.6% in 2016 on a one-time inventory drag, reduced investment in business equipment, and the consumer spent a little less, state & local governments too. The 3.1% world growth relative softness wasn't all the U.S. as the Euro area saw slower growth of 1.7% in 2016 from 2.0% in 2015. Emerging market economies were actually stronger in 2016. Anway, world growth is expected to do better this year and next. How did Jamie Dimon put it over in Saudi Arabia this week with Trump? "Even the IMF, which is always warning about stuff, is saying the world will grow faster than expected," the head of JPMorgan Chase said. Indeed, the IMF 2017 world economic growth forecast was revised up a tenth on rounding to 3.460% in April from 3.442% in the prior forecast made in October 2016. The world economy is better than you think. Dangers, setbacks, risks, uncertainties, tensions, notwithstanding.

IMF World Economic Outlook (WEO) Titles	
Apr 2017	Gaining Momentum?
Jan 2017	A Shifting Global Economic Landscape
Oct 2016	Subdued Demand: Symptoms and Remedies
Jul 2016	Uncertainty in the Aftermath of the U.K. Referendum
Apr 2016	Too Slow for Too Long
Jan 2016	Subdued Demand, Diminished Prospects
Sep 2015	Adjusting to Lower Commodity Prices
Jul 2015	Slower Growth in Emerging Markets, a Gradual Pickup in Advanced Economies
Apr 2015	Uneven Growth: Short- and Long-Term Factors
Jan 2015	Cross Currents
Oct 2014	Legacies, Clouds, Uncertainties
Jul 2014	An Uneven Global Recovery Continues
Apr 2014	Recovery Strengthens, Remains Uneven
Jan 2014	Is the Tide Rising?
Oct 2013	Transitions and Tensions
Jul 2013	Growing Pains
Apr 2013	Hopes, Realities, and Risks
Jan 2013	Gradual Upturn in Global Growth During 2013
Oct 2012	Coping with High Debt and Sluggish Growth
Jul 2012	New Setbacks, Further Policy Action Needed
Apr 2012	Growth Resuming, Dangers Remain
Jan 2012	Global Recovery Stalls, Downside Risks Intensify

MARKETS OUTLOOK

	31-Mar 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019
30-Yr Treasury	3.03	3.10	3.20	3.40	3.60	3.70	3.80	4.00	4.10	4.10	4.10	4.20
10-Yr Note	2.40	2.50	2.70	3.00	3.20	3.40	3.50	3.70	3.80	3.90	3.90	4.00
5-Yr Note	1.93	2.10	2.40	2.70	3.00	3.20	3.30	3.50	3.60	3.70	3.70	3.90
2-Yr Note	1.25	1.50	1.75	2.00	2.25	2.50	2.75	3.00	3.20	3.35	3.35	3.50
3-month Libor	1.15	1.50	1.70	1.95	2.20	2.45	2.70	2.95	3.20	3.45	3.45	3.70
Federal Fund Rate	1.00	1.25	1.50	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.25	3.50
2s/10s spread	115	100	95	100	95	90	75	70	60	55	55	50
Libor/funds spread	15	25	20	20	20	20	20	20	20	20	20	20

Bonds yields fell and rose with the stock market this week. The biggest sell-off since Trump was elected in November took place on Wednesday on new revelations about Russia. The sell-off was partly technical as supports gave way and some gaps left on the charts back from the French election rally from that first Sunday, April 21 vote, were filled finally. The chart of Dow industrials stocks the last three months is one of the strangest patterns we recall



seeing in years, making it hard for equity strategists and technicians to come up with a believable story for why stocks do what they do. There has been no new high since the March 1 rally after Trump's State of the Union address. 10-yr Treasury yields fell as low as 2.18% on Thursday and closed the week at 2.23%. The bond rally this week caused some Wall Street firms to cut their year-end guess on where 10-yr yields would settle. The 3.0% end of 2017 figure that we have and was popular with many forecasters has been pruned back. We will keep it at 3% for now, as we still expect three more Federal Reserve rate hikes in 2017, June, September, December, to a Fed funds rate of 1.75% at year-end.

FEDERAL RESERVE POLICY

The Fed meets June 13-14 to consider its monetary policy. We expect a rate hike. We always do. There could be some arguments down there in Washington. There always are. Do they go with economic theory or look askance at the recent trend of inflation that seems to have fallen further away from reaching their 2.0% objective? The theory being the 4.4% unemployment rate indicates the economy is at full employment and this means inflation will eventually heat up ("we're telling ya") if the Fed doesn't move interest rates back to normal. Actually, the theory is that rates should be higher than 3.0% normal when the economy is at full employment. We will see, the decision date is weeks away. July Fed funds futures closed Friday at June meeting rate hike odds of 70% despite the stock market turmoil.

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	17-May	10-May	3-May	26-Apr	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2464.638	2464.815	2464.792	2464.730	479.782
Federal agency debt securities	8.834	11.829	11.829	11.829	0.000
Mortgage-backed securities	1778.109	1769.016	1769.015	1769.013	0.000
Primary credit (Discount Window)	0.023	0.000	0.024	0.011	23.455
Term auction credit (TAF auctions)	0.000	0.000	0.000	0.000	150.000
Asset-backed TALF	0.000	0.000	0.000	0.000	
Maiden Lane (Bear)	1.709	1.709	1.709	1.709	29.287
Maiden Lane II (AIG)	0.000	0.000	0.000	0.000	0.000
Maiden Lane III (AIG)	0.000	0.000	0.000	0.000	0.000
Central bank liquidity swaps	0.036	0.035	0.035	0.080	62.000
Federal Reserve Assets	4513.6	4520.0	4517.6	4516.5	961.7
3-month Libor %	1.18	1.18	1.17	1.17	2.82
Factors draining reserves					
Currency in circulation	1548.437	1548.378	1546.200	1542.724	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	167.270	187.269	186.667	122.323	0.000
Reserve Balances (Net Liquidity)	2247.673	2219.918	2200.821	2200.670	24.964
Treasuries within 15 days	11.910	20.483	20.483	14.058	14.955
Treasuries 16 to 90 days	44.608	37.862	37.862	46.551	31.549
Treasuries 91 days to 1 year	230.777	223.204	223.203	200.650	69.272
Treasuries over 1-yr to 5 years	1195.573	1170.574	1170.570	1194.564	170.807
Treasuries over 5-yrs to 10 years	349.054	384.944	384.939	381.211	91.863
Treasuries over 10-years	632.716	627.747	627.733	627.696	101.337

**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08

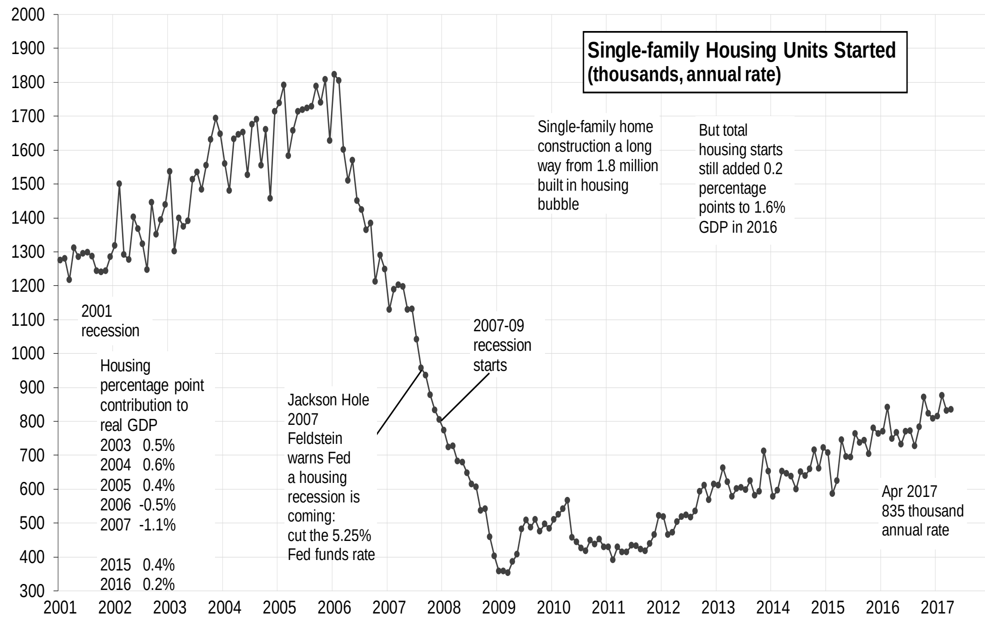
OTHER ECONOMIC NEWS THIS WEEK

Economy loses one growth engine in housing, gains one in faster output

[Commentary written after the news was released on Tuesday, May 16]

Breaking economy news. Great headlines this morning on making the American economy great again. First Ford is laying off 10% of its staff worldwide, but not telling us how many more robots they are hiring. Now there are not going to be many new jobs for those up on house tops pounding in nails either. Housing starts down 2.6% in April to 1.172 million, and permits to build homes down 2.5% to 1.229 million in April at an annual rate. The good news came later this morning with a 1% jump in April industrial production to start the economy off this quarter on a strong note. Factory production or manufacturing fell 0.4% in March with half of that due to automakers, but manufacturing production is back in April, surging 1.0%. Let's hope this good factory news today means there are more humans running the machines and not just shop floors humming with robots whistling a happy tune while they work.

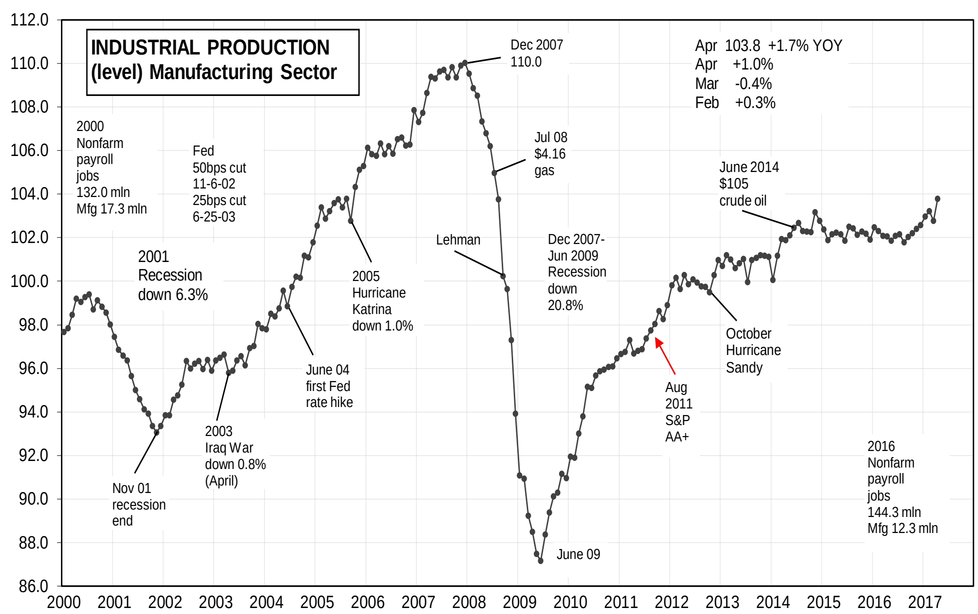
Housing isn't exactly in a soft patch, but new construction has clearly stalled and this could have negative repercussions for the economic outlook later this year. The picture was quite mixed by regions with a small gain in the West and big jump in the Midwest dragged down in total with huge declines in the Northeast and in the South. The picture is mixed certainly, but with an overall theme of weakness.



Homebuilders may be ebullient and consumers are too, but construction is currently in the doldrums with little sign of an imminent pickup. In the first quarter, residential housing construction shot the lights out adding 0.5 percentage points to the 0.7% GDP growth which is as much as it ever added to growth in the housing bubble years a decade ago. But it does not look like housing starts will be adding much to the second quarter growth.

Net, net, the economy loses an engine with housing starts failing to climb today, but the outlook is brighter for America's factory workers as manufacturing production shot up 1.0% in April, more than reversing that -0.4 pothole of a decline seen in March. Production increases were widespread across industries and the former drag from oil & gas drilling production is gone with mining jumping 1.2% in April and 7.3% above this time last year.

The data today are mixed with homebuilders cooling their jets and building fewer homes, but factory production is positively hopping with more goods being made here in America. Consumer goods production is running flat out rising 1.2% in April following on a 1.2% jump in March after weakness seen in Trump's first two months in office.



We wouldn't characterize the economic news today as overly bright for the outlook, no need for sunglasses, the Trump economics team still has its work cut out for it to get the economy up to the faster 3 percent speed they keep talking about. But it is important information today nonetheless as the drop in production in March looks like a one-off and makes us hopeful that the second quarter will see a resumption of growth back to trend. The Fed can continue with its gradual pace of rate hikes knowing that the economy's fundamentals remain solid. We still look for a rate hike at the Fed's June meeting. Today the economy is somewhat better than you think.

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